

1 included a named plaintiff that had standing to assert the 2006-24 claims. *See*
2 **SAC Appendix Exhibit E.** As such, Plaintiff GBPHB derives tolling from
3 Vermont's standing to pursue those claims. *See SAC Appendix Exhibit F.* As of
4 the date of the filing of the Federal Action in January 2010, the value of the
5 Certificates had diminished considerably, and according to GBPHB's custodial
6 statements, was priced at \$0.9428, causing GBPHB to suffer injury as a result.

7 **D. Defendant CWMBBS Offerings**

8 81. Defendant CWMBBS issued \$56,178,680,394 of Countrywide MBS in
9 87 separate Offerings between June 2005 and October 2007 pursuant to five Shelf
10 Registration Statements, Original Basic Prospectuses and later-filed Prospectus
11 Supplements as set forth above in ¶44 herein and in the FAC at ¶37. All 87
12 Offerings were included, for the first time, in the Washington State Complaint and
13 thereafter included in the Luther Amended Complaint, Consolidated Luther
14 Complaint, Federal Complaint and FAC. *See SAC Appendix Exhibit D.*

15 82. Pursuant to the Court's Countrywide Tolling Decision, the allegations
16 set forth herein are limited to those CWMBBS Offerings which the Luther Plaintiffs
17 had standing to pursue while the case was pending in California state court. As a
18 result, Plaintiffs maintain standing to pursue Securities Act claims on one (1)
19 Countrywide MBS Offering issued pursuant to one (1) CWMBBS Registration
20 Statement, as set forth in detail below.

21 83. As set forth below, and also in the Certification annexed hereto,
22 OPERS purchased the **CWHL 2006-HYB3 ("2006-HYB3") Certificates, Class**
23 **2A1A**, pursuant and traceable to the misleading Offering Documents:

Certificates Purchased	Units Purchased	Price Per Unit	Date of Purchase(s)	Purchased From
CWHL 2006- HYB3, Class 2A1A	1,076,000.00	\$1.0002	April 27, 2006	CSS
CWHL 2006- HYB3, Class 2A1A	154,493.47	\$0.9919	August 21, 2007	CSC

1 Plaintiff OPERS was named as a representative Plaintiff in the Federal Action for
2 the first time on July 13, 2010 when the FAC was filed. OPERS' Sections 11 and
3 15 claims on behalf of all purchasers of the 2006-HYB3 Certificates were tolled in
4 accordance with the Countrywide Tolling Decision since at least June 12, 2008
5 when Washington State was named as a plaintiff in the Washington State
6 Complaint. According to the Certification filed with its motion for lead plaintiff
7 on April 2, 2010, Washington State purchased the 2006-HYB3 Certificates and had
8 standing to assert Securities Act claims in connection therewith. Each complaint
9 filed subsequent to the Washington State Complaint, including the Amended
10 Luther Complaint, the Luther Consolidated Complaint, the Federal Complaint and
11 the FAC, included a named plaintiff that had standing to assert the 2006-HYB3
12 Claims. **See SAC Appendix Exhibit E.** As such, Plaintiff OPERS derives tolling
13 from Washington State's standing to pursue those claims.⁸ **See SAC Appendix**
14 **Exhibit F.** As of the date of the filing of the Federal Action in January 2010, the
15 value of the Certificates had diminished considerably, and according to OPERS'
16 custodial statements, was priced at \$0.6877, causing OPERS to suffer injury as a
17 result.

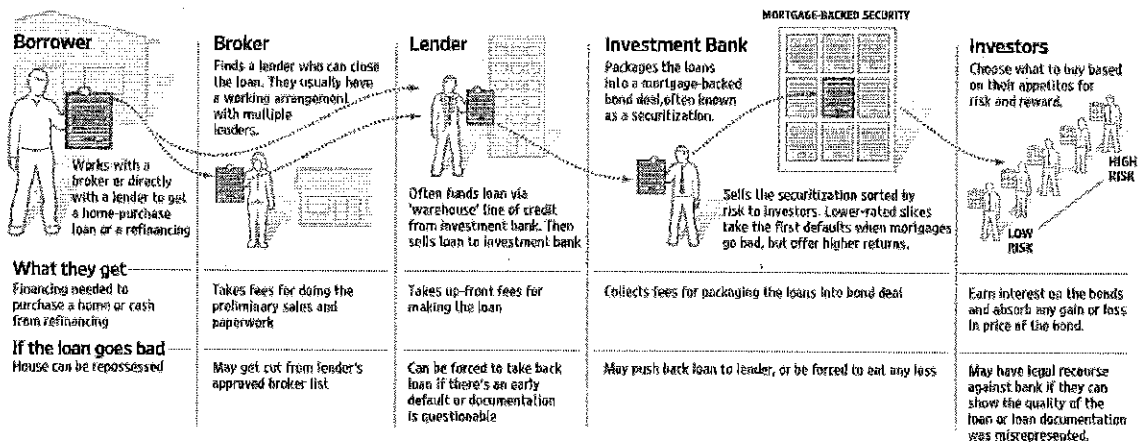
18 VI. BACKGROUND

19 A. Countrywide Was a Leading Issuer and Underwriter of 20 Mortgage-Backed Securities

21
22 84. As illustrated below, a mortgage securitization is where mortgage
23 loans are acquired, pooled together, and then sold to investors, who acquire rights
24 in the income flowing from the mortgage pools.

25
26 ⁸ In addition to Washington State's standing to pursue the 2006-HYB3 claims,
27 OPERS relies on the standing of MASH as of the filing of the Amended Luther
28 Complaint. According to the Certification filed with its motion for lead plaintiff
on April 2, 2010, MASH purchased the 2006-HYB3 Certificates and had standing
to assert Securities Act claims in connection therewith.

Follow the Mortgage What happens to your mortgage after you sign on the dotted line



Source: WSJ Reporting

85. When mortgage borrowers make interest and principal payments, the cash flow is distributed to the holders of MBS certificates in order of priority, based on the specific tranche held. The highest tranche (also referred to as the senior tranche) is first to receive its share of the mortgage proceeds and is also the last to absorb any losses should mortgage borrowers become delinquent or default on their mortgages. Because the lower tranches are designed to provide a cushion, diminished cash flows to the lower tranches results in impaired value of the higher tranches, as, among other reasons, there is less certainty of the continued cash flows to the higher tranches.

86. The securitization of loans fundamentally shifts the risk of loss from mortgage loan originators to investors who purchase an interest in the securitized pool of loans. When the originator holds a mortgage through the term of the loan, it profits from the borrower's payment of interest and repayment of principal, but it also bears the risk of loss if the borrower defaults and the property value is not sufficient to repay the loan. As a result, traditionally, the originator was economically vested in establishing the creditworthiness of the borrower and the true value of the underlying property through appraisal before issuing the mortgage loans. In securitizations where the originator immediately sells the loan to an investment bank, it does not have the same economic interest in establishing

1 borrower creditworthiness or a fair appraisal value of the property in the loan
2 origination process.

3 87. In the 1980s and 1990s, securitizations were generally within the
4 domain of Government Sponsored Enterprises (“GSE”), *i.e.*, the Federal National
5 Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage
6 Corporation (“Freddie Mac”), which would purchase loans from originators.
7 Investors in these early GSE securitizations were provided protections since the
8 underlying loans were originated pursuant to strict underwriting guidelines.

9 88. Between 2001 and 2006, however, there was dramatic growth in non-
10 GSE loan originations and securitizations such that non-GSE securitizations grew
11 330%, becoming a \$1.48 trillion industry.

12 89. The market for adjustable rate mortgages (“ARMs”), including
13 interest-only and negative amortization loans, grew concurrently with the boom in
14 subprime and Alt-A loan originations and securitizations. ARMs increased from
15 \$355 billion in 2001 to \$1.3 trillion in 2006. Mortgage Market Statistical Annual,
16 Vol. 1 (2007), at 4. Such growth coincided with the increase in popularity of so-
17 called “exotic” or non-traditional ARMs which had fixed interest rates for a limited
18 period before “resetting” during the life of the loan to significantly higher
19 adjustable rates. These non-traditional ARMs included “2/28 or 3/27 ARMs”
20 (many with below-market teaser rates for two or three years before conversion to
21 the fully-indexed rate); interest-only ARMs (permitting interest-only payments for
22 a set period of time during which the rate may fluctuate, resulting in negative
23 amortization and rising principal); option payment ARMs (offering up to four
24 payment options, including minimum and interest-only payments, which, if
25 chosen, result in negative amortization and rising principal); and 40-year ARMs (in
26 which payments are calculated based on a 40-year payment term but where the
27 loan terminates in 30 years, resulting in a final balloon payment). Origination of
28 non-traditional ARMs increased 278% between 2004 and 2006 – from \$205 billion

1 to \$775 billion. Mortgage Market Statistical Annual, Vol. 1 (2007), at 6.

2 90. Here, the Certificate collateral was composed of a substantial number
3 of non-traditional adjustable mortgages, interest-only and negative amortization
4 loans. These types of loans presented the greatest potential for “payment shock” to
5 the borrower since they provided for initially small monthly payments based on
6 low fixed rates which then reset thereafter to significantly higher monthly payment
7 amounts based on adjustable interest rates. Although these loans were not
8 traditional, the underwriting guidelines still required the loans to be originated
9 responsibly and in accordance with those guidelines. Yet, Countrywide would
10 routinely provide loans to borrowers who could only afford the short-term “teaser”
11 rates (or, even to those that could not even afford the teaser rates) – not the full
12 payments that would be required after the short-term rates reset. Although these
13 types of loans were designed for high net worth investors who were capable of
14 earning higher returns through investment than in making interest and principal
15 payments upfront, Countrywide routinely sold these loans to unsophisticated
16 borrowers who were unable to make the required payments after the loans reset –
17 and frequently, to those who could not even make the “teaser” payments, leading
18 to early defaults on the loans.

19 **B. Countrywide’s Origination and Securitization Operations**

20 91. CFC set up Defendants CWALT, CWMBS, CWABS, and CWHEQ,
21 the Depositors in this case, as “limited purpose finance entities” solely for the
22 purpose of facilitating the issuance of the Certificates. CHL acted as the servicer
23 of the mortgages and CSC, Countrywide’s underwriting division, along with the
24 other Underwriter Defendants, marketed and sold the securities. Although
25 Defendants CWALT, CWMBS, CWABS, and CWHEQ served as the Depositors
26 for the Issuing Trusts and issued the Registration Statements, this process was
27 directed and controlled by the Countrywide Defendants, the Individual Defendants,
28 and Sambol.

1 92. With respect to the Certificates at issue here, the Registration
2 Statements and each of the Prospectus Supplements contained material
3 misstatements concerning, *inter alia*, the quality of the loans supporting the MBS
4 associated with each trust, including, specifically, statements about (1) the
5 underwriting process and standards by which mortgages held by the Issuing Trusts
6 were originated, and (2) the values of the real estate securing the mortgages pooled
7 in the Issuing Trusts, expressed in part as the average LTV ratios of the underlying
8 mortgages and the appraisal standards by which such real estate values were
9 obtained.

10 93. Each MBS sold to Plaintiffs was sold pursuant to a Registration
11 Statement. The Prospectus Supplements, which were filed at the time that the
12 Certificates were sold to Plaintiffs, incorporated by reference each of the
13 Registration Statements they were issued pursuant to. The Prospectus
14 Supplements contained specific disclosures concerning each Issuing Trust.
15 Nonetheless, in each Prospectus Supplement, as set forth herein, the Issuer
16 Defendants and the Underwriter Defendants made the same representations
17 concerning CHL's standards in originating the mortgages and valuing the
18 properties underlying the Issuing Trusts.

19 94. CWALT filed six Registration Statements with the SEC, *see* **SAC**
20 **Appendix Exhibit C**, registering mortgage-backed securities backed primarily by:

- 21 a) first lien mortgage loans secured by one- to four-family residential
22 properties;
- 23 b) mortgage loans secured by first liens on small multi-family residential
24 properties, such as residential apartment buildings or projects
25 containing five to fifty residential units;
- 26 c) collections arising from one or more types of the loans described
27 above which are not used to make payments on securities issued by a
28 trust fund, including excess servicing fees and prepayment charges;

1 d) mortgage pass-through securities issued or guaranteed by Ginnie Mae,
2 Fannie Mae, or Freddie Mac; or

3 e) mortgage-backed securities evidencing an interest in, or secured by,
4 loans of the type that would otherwise be eligible to be loans included
5 in a trust fund and issued by entities other than Ginnie Mae, Fannie
6 Mae, or Freddie Mac.

7 95. CWHEQ filed four Registration Statements with the SEC, *see* SAC
8 **Appendix Exhibit C**, registering mortgage-backed securities backed primarily by:

9 a) first lien mortgage loans secured by first and/or subordinate liens on
10 one- to four-family residential properties;

11 b) closed-end and/or revolving home equity loans, secured in whole or in
12 part by first and/or subordinate liens on one- to four-family residential
13 properties; or

14 c) home improvement loans, secured by first or subordinate liens on one-
15 to four-family residential properties or by personal property security
16 interests, and home improvement sales contracts, secured by personal
17 property security interests.

18 96. CWABS filed five Registration Statements with the SEC *see* SAC
19 **Appendix Exhibit C**, registering mortgage-backed securities backed primarily by:

20 a) first lien mortgage loans secured by one- to four-family residential
21 properties;

22 b) mortgage loans secured by first liens on small multi-family residential
23 properties, such as residential apartment buildings or projects
24 containing five to fifty residential units;

25 c) closed-end and/or revolving home equity loans, secured in whole or in
26 part by first and/or subordinate liens on one- to four-family residential
27 properties; or
28

- 1 d) home improvement loans, secured by first or subordinate liens on one-
2 to four-family residential properties or by personal property security
3 interests, and home improvement sales contracts, secured by personal
4 property security interests.

5 97. CWMBS filed five Registration Statements with the SEC, *see* SAC
6 **Appendix Exhibit C**, registering mortgage-backed securities backed primarily by:

- 7 a) first lien mortgage loans secured by one- to four-family residential
8 properties or participations in that type of loan;
9 b) mortgage pass-through securities issued or guaranteed by Ginnie Mae,
10 Fannie Mae, or Freddie Mac; or
11 c) private mortgage-backed securities backed by first lien mortgage
12 loans secured by one- to four-family residential properties or
13 participations in that type of loan.

14 98. Prior to securitization, Countrywide sent the "Loan Level File" to the
15 Rating Agencies to enable them to rate the Certificates. Upon receipt of the "Loan
16 Level File," S&P would run the loan tape through both its "LEVELS" and
17 "SPIRE" Models. Moody's would run the loan tape through its M-3 Model.
18 These models analyzed 50-80 loan characteristics (*e.g.*, FICO score, LTV ratio,
19 property location, etc.), in order to estimate the number of loans that were likely to
20 default and the corresponding amount of the dollar loss resulting from such default.

21 99. As a condition to the issuance of the Certificates, the Rating Agencies
22 had to assign pre-determined ratings to the Certificates. Yet, as detailed herein, the
23 ratings at the time of issuance were vastly higher than they should have been and
24 failed to represent the true value of the Certificates due to incorrect information
25 provided by Countrywide and widespread misrepresentations in the origination
26 process. Accordingly, despite the fact that the Rating Agencies assigned
27 investment-grade ratings, the Certificates were far riskier than other investments
28 with the same ratings.

100. The models purported to calculate the amount of “credit enhancement” required to assign a specific set of Certificates “AAA” ratings. As a result of relatively low levels of credit enhancement being required, as reflected in **SAC Appendix Exhibit G**, 90% of the Certificates were assigned AAA/maximum safety ratings.

101. These ratings, although based on inaccurate assumptions, were critical to institutional investors – public pension funds, banks, insurance companies and mutual funds – whose investment guidelines restrict investments based on a security’s rating.

VII. Evidence of SYstemic Disregard of Stated Loan Origination Guidelines Contained IN Offering documents

A. Exponential Increase in Certificate Default Rates in Months After Issuance No Matter When Offering Occurred Evidences Disregard of Origination Guidelines

102. The defective nature of the mortgage collateral underlying the Certificates is reflected by the recurring pattern of exponential increases in borrower delinquencies in the months after each of the Offerings was commenced.

103. Four months after each of the Offerings was commenced, borrower delinquency and default rates on the underlying mortgage collateral had increased by a staggering 1,816% – from an average of 0.14% to over 2.7% of the mortgage loan balance. By the sixth month after issuance of the Certificates, delinquency and default rates had increased 3,064% to an average of 4.5% of the mortgage loan balance. And shockingly, by 12 months after the Offering date, delinquency and default rates had increased 8,508% from issuance to 12.1% of the mortgage loan balance. Borrower default and delinquency rates in the underlying mortgage collateral have continued to increase.

104. These early payment defaults and delinquency rates are reflective of a systematic disregard for underwriting guidelines. As reported by the Federal

1 Bureau of Investigation ("FBI") in its 2006 and 2007 Mortgage Fraud Reports, a
2 study of three million residential mortgage loans found that between 30% and 70%
3 of early payment defaults were linked to significant misrepresentations in the
4 original loan applications. The study cited by the FBI and conducted by Base
5 Point Analytics found that loans that contained egregious misrepresentations were
6 five times more likely to default in the first six months than loans that did not. The
7 misrepresentations included income inflated by as much as 500%, appraisals that
8 overvalued the property by 50% or more and fictitious employers and falsified tax
9 returns. The 2006 FBI report also cited studies by a leading provider of mortgage
10 insurance, Radian Guaranty Inc., in concluding that the top states for mortgage
11 fraud – including the states where the MBS collateral was principally originated –
12 were also the top states with the highest percentage of early payment defaults.

13 105. As set forth above, it is now apparent that Countrywide mortgage
14 originators routinely encouraged such misstatements in loan applications.
15 Unsurprisingly, this has resulted in dismal performance of the loans. As of the
16 filing of the Amended Luther Complaint in October 2008, borrower delinquency
17 and default rates had risen to an average of approximately 42% of the mortgage
18 loan collateral underlying the Certificates, forcing the Rating Agencies to
19 downgrade substantially all of the Certificates to at or near junk bond status. As of
20 the date of the filing of the complaint in the above-captioned action in January
21 2010, *over 59%* of mortgage collateral was considered to be in some form of
22 delinquency or default, with *over 85%* of the mortgage loans underlying the
23 Offerings issued by Defendant CWALT at issue herein being delinquent or in
24 default.

25 106. Despite assurances by the Defendants in the Offering Documents that
26 the mortgage loans collateralizing the Certificates were originated pursuant to
27 Countrywide's stated guidelines, nothing could have been further from the truth.
28

B. Rating Agencies Collapsed Certificate Ratings to "Junk Bond" Levels Due to Undisclosed "Aggressive Underwriting" Practices

107. The Rating Agencies rated the Certificates pursuant to the following twenty-three (23) level rating system:

		Definition	Moody's	S & P	Fitch
		Investment Grade			
	10.0	US Treasuries	***	***	***
	9.5	Prime, maximum safety	Aaa	AAA	AAA
	9.0	Very high grade/quality	Aa1	AA+	AA+
	8.5	"	Aa2	AA	AA
	8.0	"	Aa3	AA-	AA-
	7.5	Upper medium quality	A1	A+	A+
	7.0	"	A2	A	A
	6.5	"	A3	A-	A-
	6.0	Lower medium grade	Baa1	BBB+	BBB+
	5.5	"	Baa2	BBB	BBB
	5.0	"	Baa3	BBB-	BBB-
Color code	Number	Definition	Moody's	S & P	Fitch
		Speculative grade			
	4.5	Speculative	Ba1	BB+	BB+
	4.0	"	Ba2	BB	BB
	3.5	"	Ba3	BB-	BB-
	3.0	Highly speculative	B1	B+	B+
	2.5	"	B2	B	B
	2.0	"	B3	B-	B-
	1.5	Substantial risk	Caa1	CCC+	CCC+
	1.0	In poor standing	Caa2	CCC	CCC
	0.5	"	Caa3	CCC-	CCC-
	0.0	Extremely speculative	Ca	CC	CC
	0.0	Maybe in or extremely close to default	C	C+,C,C-	C+,C,C-
	0.0	Default		D	D

108. As noted above, the Rating Agencies initially assigned the highest ratings of AAA/maximum safety to 90%, or \$16.03 billion, of the Certificates at issue herein.

109. As of the filing of this Complaint, as set forth directly above, the underlying collateral has largely failed, with **over 60%** of the total mortgage loan balance now severely delinquent, in default, repossessed, in bankruptcy or in foreclosure. This performance was an indication to the Rating Agencies, including

1 S&P and Moody's, of pervasive underwriting failures in the origination of the
2 collateral which ultimately led to widespread and deep downgrades of most of the
3 Certificate classes.

4 110. On or about July 10, 2007, S&P publicly announced it was revising
5 the methodologies used to rate numerous Certificates because the performance of
6 the underlying collateral "called into question" the accuracy of the loan data. This
7 announcement triggered several government investigations which only began
8 reporting their findings in 2008. Specifically, S&P announced that it was revising
9 its methodology assumption to require increased "credit protection" for rated
10 transactions. S&P reiterated that it would also seek in the future to review and
11 minimize the incidence of potential underwriting abuse given "the level of
12 *loosened underwriting* at the time of loan origination, misrepresentation and
13 speculative borrower behavior reported for the 2006 ratings."

14 111. One day later, on July 11, 2007, Moody's announced it was also
15 revising its methodology used to rate the Certificates, and anticipated Certificate
16 downgrades in the future. Moody's did in fact significantly downgrade most of the
17 Certificate classes, noting "aggressive underwriting" used in the origination of the
18 collateral.

19 112. As a result, the Certificates were downgraded as many as 22 levels
20 with, for example, 90%, or \$14.5 billion, of the total \$16.03 billion of Certificates
21 initially rated AAA/maximum safety now having been downgraded from AAA to
22 "Ba1" or below, meaning these Certificates were not only designated "junk
23 bonds," but were assessed to be in danger of "imminent default." Over 93%, or
24 \$16.6 billion, of the Certificate tranches have now been downgraded, with 91%, or
25 \$16.2 billion, of the total Certificates at issue having now been downgraded to
26 speculative "junk" status.

27 113. Countrywide's systematic disregard for its underwriting guidelines led
28 to dramatic downgrades of the Certificates as set forth directly above. Currently,

1 91% (\$14.5 billion) of the \$17.83 billion of Certificates initially rated
2 AAA/maximum safety have been downgraded to speculative “junk” status or
3 below. Delinquency and default rates on the Countrywide loans in the Certificates
4 have risen exponentially by over 41,000% since issuance of the Certificates – from
5 0.14% as of the respective Offering dates to *over 60%* as of May 2010.

6 114. Further, as set forth more fully below, disclosures emerged well after
7 the issuance of the Certificates with respect to the loan originators which further
8 evidenced that they had engaged in underwriting practices which were wholly
9 inconsistent with the guidelines set forth in the Registration Statements and
10 Prospectus Supplements.

11 C. Numerous Government Investigations Reveal the Falsity of the
12 Offering Documents

13 115. Although the poor performance of the MBS alone strongly suggests
14 that Countrywide’s lending practices were far from was disclosed in the Prospectus
15 Supplements, there is substantial additional evidence that also indicates that the
16 statements in the Prospectus Supplements about loan quality and loan underwriting
17 practices were materially inaccurate. Among this evidence are statements by
18 former Countrywide employees, facts which have emerged in ongoing litigation
19 involving the SEC (including a recent judicial opinion dealing with disclosures by
20 Countrywide), facts set out in complaints filed by state attorneys general, facts set
21 out in filings by private litigants and information from press reports and other
22 sources.

23 116. Taken together, these facts indicate that, while the Offering
24 Documents represented that Countrywide’s underwriting of mortgages was
25 designed to ensure the borrower’s ability to repay the mortgage and the adequacy
26 of the collateral supporting the mortgage, in reality Countrywide’s underwriting
27 practices were actually designed to originate as many mortgage loans as possible
28 without regard to the ability of borrowers to afford such mortgages. Indeed,

1 contrary to the representations in the Registration Statements and Prospectus
2 Supplements, it has now been revealed that Countrywide's loan originators
3 systemically disregarded and/or manipulated the income, assets and employment
4 status of borrowers seeking mortgage loans in order to qualify these borrowers for
5 mortgages that were then pooled and used as collateral for the MBS sold to
6 Plaintiffs. In many instances, this was done by inflating borrowers' stated income,
7 or facilitating income inflation by encouraging ineligible borrowers to resort to "no
8 documentation loans" and "stated income loans." In other cases, Countrywide
9 customers were steered to more expensive, higher interest loans, such as subprime
10 and "alternative" mortgages, which they would not likely be able to repay, because
11 making such loans allowed Countrywide to increase the number of attractive
12 mortgages it could sell to the secondary mortgage markets. As set forth below,
13 Countrywide's notorious origination practices were pervasive throughout the
14 United States and throughout the time period during which the Offerings were
15 issued.

16 117. On or about March 10, 2008, the FBI disclosed that it had initiated a
17 probe into Countrywide's mortgage lending practices, including manipulation of
18 the subprime and non-traditional loan markets, knowledge of and disregard for
19 underwriting inaccuracies and misrepresentations, and Countrywide's specific
20 instructions to underwriters not to scrutinize certain types of loans it issued. The
21 next day, *The Wall Street Journal* published an article detailing the FBI
22 investigation of Countrywide's lending practices. According to the sources
23 interviewed by *The Wall Street Journal*, federal investigators were finding that
24 "Countrywide's loan documents often were marked by dubious or erroneous
25 information about its mortgage clients, according to people involved in the matter.
26 The company packaged many of those mortgages into securities and sold them to
27 investors, raising the additional question of whether Countrywide understated the
28 risks such investments carried." Subsequently, on April 2, 2008, a federal

1 bankruptcy judge overseeing the proceedings of more than 300 Countrywide-
2 related bankruptcies ordered a further inquiry into the misconduct, and specifically,
3 the illegal inflation of fees throughout the loan process that had been occurring at
4 Countrywide.

5 118. On June 4, 2009, the SEC filed a complaint against Mozilo,
6 Countrywide's former Chief Executive Officer, and against two Defendants in this
7 case, Sambol and Sieracki (the "SEC Complaint"). The SEC Complaint alleges
8 that the defendants in that case made material false statements in Countrywide's
9 SEC filings and in other forums about the quality of Countrywide's residential
10 mortgage loans and about the underwriting process for those loans. According to
11 the SEC, the underwriting process for Countrywide loans was far less rigorous than
12 what the defendants in that case had stated and, consequently, the quality of
13 Countrywide's loans was much poorer than was indicated by those public
14 statements.

15 119. The basis for the allegations in the SEC Complaint – that
16 Countrywide and its officers substantially overstated the quality of the company's
17 residential mortgage loan underwriting and, as a result, issued mortgage loans of a
18 far worse quality than Countrywide publicly disclosed – are materially similar to
19 the allegations made by Plaintiffs in this case. Although the statements targeted by
20 the SEC were made to Countrywide's shareholders in SEC filings, statements
21 made in Offering Documents for securities that securitized the mortgage collateral
22 were similarly false and misleading to MBS investors.

23 120. The SEC Complaint alleges, among other things:

- 24
- 25 • Countrywide embarked on a strategy of underwriting a
26 higher number of exception loans. The SEC alleges that
27 "[t]he elevated number of exceptions resulted largely
28 from Countrywide's use of exceptions as part of its
matching strategy to introduce new guidelines and
product changes." SEC Complaint, ¶ 29. By February

1 2007, internal risk management “noted that the
2 production divisions continued to advocate for, and
3 operated pursuant to, an approach based upon the
4 matching strategy alone. ... Additionally, [a senior risk
5 management employee warned [Sambol] that, ‘I doubt
6 this approach would play well with regulators, investors,
7 rating agencies etc. *To some, this approach might seem
like we’ve simply ceded our risk standards and balance
sheet to whoever has the most liberal guidelines.*” SEC
Complaint, ¶ 44 (emphasis added).

- 8 • Countrywide’s risk management reported to the credit
9 risk committee on June 28, 2005, that there was
10 “evidence of borrowers misrepresenting their income and
11 occupation on reduced documentation loan applications.”
SEC Complaint, ¶ 37.
- 12 • By June 2006 “both Mozilo and Sambol were aware ...
13 that a significant percentage of borrowers who were
14 taking out stated income loans were engaged in mortgage
15 fraud.” SEC Complaint, ¶ 40. For example, “[o]n June
16 2, 2006, Sambol received an email reporting on the
17 results of a quality control audit at Countrywide Bank
18 that showed that 50% of the stated income loans audited
by the bank showed a variance in income from the
borrowers’ IRS filings of greater than 10%. Of those,
69% had an income variance of greater than 50%.” *Id.*
- 19 • Angelo Mozilo, Countrywide’s CEO, noted in an April
20 13, 2006 email “that he had ‘personally observed a
21 serious lack of compliance within our origination system
22 as it relates to documentation and generally a
23 deterioration in the quality of loans originated versus the
pricing of those loan [sic].” SEC Complaint, ¶ 49.
- 24 • A December 13, 2007 internal Countrywide
25 memorandum reveals, “Countrywide had reviewed
26 limited samples of first- and second-trust-deed mortgages
27 originated by Countrywide Bank during the fourth
28 quarter of 2006 and the first quarter of 2007 in order to
get a sense of the quality of file documentation and
underwriting practices, and to assess compliance with
internal policies and procedures. The review resulted in

1 ... the finding that borrower repayment capacity was not
2 adequately assessed by the bank during the underwriting
3 process for home equity loans. More specifically, debt-
4 to-income (DTI) ratios did not consider the impact of
principal [negative] amortization or any increase in
interest.” SEC Complaint, ¶ 56.

- 5 • A senior risk management employee warned defendant
6 Sambol on May 22, 2005 “of the likelihood of
7 significantly higher default rates in loans made on an
8 exception basis: ‘[t]he main issue is to make sure
9 everyone’s aware that we will see higher default rates.’”
10 SEC Complaint, ¶ 54. According to the SEC Complaint,
11 the senior risk management employee explained to
12 Sambol “that exceptions are generally done at terms more
13 aggressive than our guidelines,” and continued that
14 ‘[g]iven the expansion in guidelines and the growing
15 likelihood that the real estate market will cool, this seems
16 like an appropriate juncture to revisit our approach to
17 exceptions.’ [The senior risk management employee
18 further] warned [Sambol] that increased defaults would
19 cause repurchase and indemnification requests to rise and
20 the performance of Countrywide-issued MBS to
21 deteriorate.” *Id.*

18 121. On November 3, 2009 U.S. District Judge John Walter denied in their
19 entirety defendants’ motions to dismiss the SEC Complaint, holding, among other
20 things, that the SEC had adequately alleged that defendants in that case had made
21 statements that materially exaggerated the quality of Countrywide’s residential
22 mortgage-backed loans.

23 122. There was apparently no dispute in the SEC litigation that defendants
24 in that case, like Defendants here, had repeatedly made statements asserting that
25 Countrywide’s residential mortgage loans were of high quality. The defendants
26 did not dispute that they had made the statements that the SEC said they had made
27 – many of these statements were in SEC filings that the defendants had
28 indisputably filed or caused to be filed. Defendants did, however, ask the court to
take judicial notice of numerous other SEC filings containing additional

1 information relating to Countrywide's loans, a request that was granted. Notably,
2 defendants used the judicially noticed documents they had brought to the court's
3 attention to "argue that the majority of the misstatements and omissions were not
4 material or misleading as a matter of law in light of Countrywide's extensive
5 disclosures and the context of the alleged misstatements or omissions." *SEC v.*
6 *Mozilo*, CV 09-3994-JFW (MANx), 2009 U.S. Dist. LEXIS 104689, at *25-26
7 (C.D. Cal. Nov. 3, 2009).

8 123. Judge Walter flatly rejected this argument, explaining that "neither
9 Countrywide's disclosures nor a careful review of the context of the statements
10 convince this Court that the alleged omissions or misstatements were immaterial or
11 not misleading as a matter of law. Accordingly, the Court concludes that the SEC
12 on the whole has adequately alleged that Defendants have made false or
13 misleading statements or omissions of material fact." *Id.* at *26.

14 124. In addition, numerous attorneys general have initiated investigations
15 into Countrywide's lending practices and also have alleged that Countrywide
16 systematically departed from the underwriting standards it professed to use to
17 originate residential loans.

18 125. The Illinois Attorney General initiated a lawsuit against Countrywide
19 and Mozilo, contending that the company and its executives sold borrowers costly
20 and defective loans that quickly went into foreclosure. *See People of the State of*
21 *Illinois v. Countrywide Fin. Corp.*, No. 08CH22994 (Cook County Ch. Ct.) (the
22 "First Illinois AG Complaint").

23 126. Additionally, the First Illinois AG Complaint alleges, based on
24 evidence from Countrywide employees whom the Illinois Attorney General
25 interviewed, that Countrywide employees were incentivized to increase the number
26 of loan originations without concern for whether the borrower was able to repay
27 the loan. Countrywide employees did not properly ascertain whether a potential
28 borrower could afford the offered loan, and many of Countrywide's stated income

1 loans were based on inflated estimates of borrowers' income. For example,
2 according to the First Illinois AG Complaint: (1) a Countrywide employee
3 estimated that approximately 90% of all reduced documentation loans sold out of a
4 Chicago office had inflated incomes; and (2) one of Countrywide's mortgage
5 brokers, One Source Mortgage Inc., routinely doubled the amount of the potential
6 borrower's income on stated income mortgage applications. Furthermore, to
7 supplement an employee's judgment as to whether a potential borrower's income
8 was "reasonable," Countrywide required its employees to utilize a website,
9 www.salary.com. Even if the stated salary was outside of the range provided by
10 the website, Countrywide employees could still approve the loan. The Illinois
11 Attorney General alleged that the "reasonableness" test contravened proper
12 underwriting practices.

13 127. As the Illinois Attorney General explained, "[t]his mounting disaster
14 has had an impact on individual homeowners statewide and is having an impact on
15 the global economy." *The New York Times* reported that the complaint, derived
16 from 111,000 pages of Countrywide documents and interviews with former
17 employees, "paints a picture of a lending machine that was more concerned with
18 volume of loans than quality." See Gretchen Morgenson, "Illinois to Sue
19 Countrywide," *N.Y. Times* (June 25, 2008).

20 128. In a second complaint filed on June 29, 2010, the Illinois Attorney
21 General further enumerated the problems with Countrywide's origination practices,
22 including that Countrywide engaged in discriminatory and predatory lending. See
23 *People of the State of Illinois v. Countrywide Fin. Corp.*, No. 10CH27929 (Cook
24 County Ch. Ct.) (the "Second Illinois AG Complaint"). There, the Illinois
25 Attorney General sets forth how CFC incentivized its employees to sell riskier
26 subprime loans with higher spreads, paying its brokers more for those riskier loans
27 than for originating prime loans.

28 129. California's Attorney General also commenced an investigation into

1 Countrywide's lending activities and filed a complaint in the Northwest District of
2 the Superior Court for Los Angeles County, entitled *People of the State of*
3 *California v. Countrywide Fin. Corp.*, No. LC081846 (Los Angeles Super. Ct.)
4 (the "California AG Complaint"). The California AG Complaint also alleged that
5 Countrywide routinely departed from its stated underwriting standards.

6 130. For example, the California AG Complaint alleged that employees
7 were incentivized to make exceptions to underwriting standards and failed to verify
8 borrower documentation and information. According to the California AG
9 Complaint, Countrywide used a system called CLUES (Countrywide Loan
10 Underwriting Expert System), to provide a loan analysis report that indicated
11 whether the loan was within Countrywide's underwriting guidelines. CLUES
12 reports indicating a loan was not originated within the purview of Countrywide's
13 underwriting guidelines often were ignored in order to effectuate the loan.

14 131. Further, consistent with the allegations of the Illinois Attorney
15 General, California Countrywide employees cited in the California AG Complaint
16 also claimed to have utilized the website www.salary.com to purportedly confirm a
17 borrower's stated income. However, according to the California AG Complaint,
18 California employees would know ahead of time the range of salaries that
19 www.salary.com would provide for a particular job and, therefore, know by how
20 much they could overstate a borrower's income. A former California loan officer
21 for Countrywide further explained that its loan officers typically told potential
22 borrowers that "with your credit score of X, for this house, and to make X
23 payment, X is the income that you need to make"; after which the borrower would
24 state that he or she made X amount of income.

25 132. Likewise, the Connecticut Attorney General filed a complaint in
26 Superior Court, Judicial District of Hartford, entitled *State of Connecticut v.*
27 *Countrywide Fin. Corp.*, No. CV08-40390945 (Hartford Super. Ct.), alleging that
28 Countrywide's employees inflated borrowers' incomes in order to qualify them for

1 loans they otherwise would not have received.

2 133. Investigations in other states such as Washington, West Virginia,
3 Indiana and Florida have confirmed many of the allegations in the Illinois,
4 California, and Connecticut complaints.

5 134. Further, the Massachusetts Attorney General set forth details of
6 Underwriter Defendant Morgan Stanley's subprime conduct in a settlement
7 agreement entered on June 24, 2010 in which Morgan Stanley agreed to pay \$102
8 million in compensation to homeowners and the Commonwealth of Massachusetts.
9 Although Morgan Stanley denied all wrongdoing, the Massachusetts Attorney
10 General set out that Morgan Stanley routinely ignored warning reports from
11 Clayton Holdings, Inc. ("Clayton"), a due diligence firm, showing that mortgages
12 originated by another defunct subprime originator, New Century Financial ("New
13 Century"), did not meet their underwriting guidelines. Despite being advised by
14 Clayton of underwriting guideline violations, Morgan Stanley repeatedly
15 purchased and securitized New Century loans that did not have sufficient
16 compensating factors to offset their failure to meet the underwriting guidelines.
17 Widespread government investigations suggest that Morgan Stanley was typical of
18 banks such as the Underwriter Defendants in ignoring warnings from due diligence
19 firms like Clayton.

20 135. On July 24, 2008, *The Los Angeles Times* reported that "three big
21 Southland lenders (are) under federal investigation; Sources say IndyMac,
22 Countrywide and New Century [have been] subpoenaed." *The Los Angeles Times*
23 further reported that officials have begun to investigate the value of mortgage-
24 backed securities:

25
26 A federal grand jury in Los Angeles has begun probing
27 three of the nation's largest subprime mortgage lenders
28 in the clearest sign yet that prosecutors are investigating
whether fraud and other crimes contributed to the
mortgage debacle.

1 *Grand jury subpoenas have been issued in recent*
2 *weeks and months to Countrywide Financial Corp.,*
3 New Century Financial Corp. and IndyMac Federal
4 Bank seeking a wide range of information, according to
5 sources with direct knowledge of the subpoenas.

6 Officials have said they are beginning to investigate
7 whether securities investors were defrauded about the
8 value of subprime mortgages they purchased, as well as
9 other possible crimes such as insider trading by
10 corporate officials who sold stock knowing their
11 holdings were about to deflate in value.

12 (emphasis added).

13 136. On October 6, 2008, certain of the Countrywide Defendants settled
14 lawsuits brought by eleven attorneys general. The settlement, valued at **\$8.4**
15 **billion**, detailed a program whereby existing loans would be modified:

16 [B]orrowers were placed in the riskiest loans, including
17 adjustable-rate mortgages whose interest rates reset
18 significantly several years after the loans were made.
19 Pay-option mortgages, under which a borrower must
20 pay only a small fraction of the interest and principal,
21 thereby allowing the loan balance to increase, also are
22 included in the modification.

23 **D. Allegations in Numerous Other Civil Lawsuits Show the Falsity of**
24 **the Offering Documents**

25 137. On February 15, 2008, Countrywide shareholders filed a consolidated
26 complaint in the U.S. District Court for the Central District of California alleging
27 derivative claims against the officers and directors of Countrywide, in an action
28 styled *In re Countrywide Fin. Corp. Derivative Litig.*, No. 07-CV-06923-MRP-
(MANx) (C.D. Cal.) (the "Derivative Complaint"). The derivative litigation was
subsequently dismissed because of the plaintiffs' lack of standing

138. The Derivative Complaint cited information obtained from several
confidential sources who were former Countrywide employees who stated that the
vast majority of Countrywide's loans were underwritten in contravention of the

1 company's stated underwriting standards. According to one of the confidential
2 sources in that complaint, a former "Underwriter II" (a Countrywide employment
3 classification) based in a Jacksonville, Florida processing center between June
4 2006 and April 2007, because of a campaign by Countrywide to increase the
5 volume of loan originations, as much as 80% of the loans originated by
6 Countrywide in that office involved significant variations from Countrywide's
7 normal underwriting standards.

8 139. According to another confidential witness cited in the Derivative
9 Complaint, a Senior Underwriter in Roseville, California, from September 2002 to
10 September 2006, Countrywide would regularly label loans as "prime" even if made
11 to unqualified borrowers (including those who had recently gone through a
12 bankruptcy and were still having credit problems). According to that confidential
13 witness, Countrywide's lending practices became riskier in 2006 and Countrywide
14 more lax in enforcing its underwriting policies.

15 140. Another confidential witness cited in the Derivative Complaint, an
16 Executive Vice President of Production Operations and later an Executive Vice
17 President of Process Improvement who worked at Countrywide for 17 years before
18 leaving in October 2005, disclosed that Countrywide created a computer system
19 (or "rules engine") that routed highly risky loans out of the normal loan approval
20 process to a central underwriting group for evaluation. The system was called the
21 Exception Processing System. According to that source, the Exception Processing
22 System identified loans that violated Countrywide's underwriting requirements.
23 However, according to the same source, loans identified by the Exception
24 Processing System as violating underwriting standards were *not* rejected. Rather,
25 Countrywide executives wanted the company's Central Underwriting group to
26 review such loans to evaluate whether these loans should require a higher price
27 (upfront points) or a higher interest rate in light of the violation at issue. Central
28 Underwriting entered information into the Exception Processing System about its

1 decisions to approve such loans and charge additional fees to the borrower.

2 141. Yet another confidential source in the Derivative Complaint, an
3 underwriter from Long Island, New York at Countrywide between March 2000
4 and January 2007, stated that Countrywide extended loans to individuals with
5 increasing debt-to-income ratios. Initially, Countrywide limited debt-to-income
6 ratios to 38%, but this rose to 50%. According to this source, Countrywide branch
7 managers' compensation was tied to loan origination volume and not the quality of
8 the loans. Thus, according to this source, branch managers pushed originators to
9 sell more loans despite the riskiness of these loans. Additional confidential sources
10 in the Derivative Complaint confirmed this.

11 142. Indeed, according to yet another confidential source in the Derivative
12 Complaint, Countrywide simply "didn't turn down loans." Rather, Countrywide
13 "did whatever they had to do to close loans' including making exceptions to
14 underwriting guidelines – everyone was motivated to increase loan volume and
15 'approv[e] things that should not have been approved.'"

16 143. On January 6, 2009, purchasers of Countrywide common shares filed
17 a second amended complaint in the U.S. District Court for the Central District of
18 California, captioned *In re Countrywide Fin. Corp. Sec. Litig.*, No. 07-CV-05295-
19 MRP-(MANx) (C.D. Cal.) (the "Securities Complaint"). Facts set forth in the
20 Securities Complaint confirm major, systematic irregularities in Countrywide's
21 loan origination practices. The Securities Complaint cited information obtained
22 from several confidential sources who were former Countrywide employees who
23 stated that the vast majority of Countrywide's loans were underwritten in
24 contravention of the company's stated underwriting standards. The securities
25 litigation recently settled for \$624 million.

26 144. Among numerous internal Countrywide sources cited in the Securities
27 Complaint, one, a supervising underwriter at Countrywide until mid-2005 who
28 oversaw the company's underwriting operations in several states (the "Supervising

1 Underwriter”), stated that the underwriting guidelines were repeatedly lowered,
2 and “very loose and lax” and designed to help Countrywide make more loans (as
3 opposed to protecting the entity that ended up taking on the credit risk that the
4 borrower would default on the mortgage).

5 145. The Supervising Underwriter further stated that from late 2004,
6 Countrywide’s Structured Loan Desks employed the Exception Processing System
7 in order to obtain approval for loans that were exceptions to and should have been
8 rejected by Countrywide’s underwriting standards. As many as 15% to 20% of the
9 loans generated each day at the Company’s Structured Loan Desks were run
10 through the Exception Processing System and very few were ever rejected.

11 146. The Supervising Underwriter further stated that if a potential borrower
12 applying for a stated income, stated asset (“SISA”) loan provided a bank name,
13 address and account number for asset verification, it was the practice at
14 Countrywide not to verify the bank balance.

15 147. According to another confidential source identified in the Securities
16 Complaint, and confirmed by an April 6, 2008 article in *The New York Times*, even
17 though Countrywide had the right to verify stated income on an application
18 through the Internal Revenue Service (“IRS”) (and this check took less than one
19 day to complete), income was verified with the IRS on only 3%-5% of all loans
20 funded by Countrywide in 2006.

21 148. The Securities Complaint also details that the appraisals obtained by
22 Countrywide underwriters were not independent or accurate. For example, since at
23 least 2005, loan officers from all of Countrywide’s origination divisions were
24 permitted to (i) hire appraisers of their own choosing, (ii) discard appraisals that
25 did not support loan transactions, and (iii) substitute more favorable appraisals by
26 replacement appraisers when necessary to obtain a more favorable LTV ratio so as
27 to qualify the loan for approval. Countrywide loan officers were allowed to lobby
28 appraisers to assign particular values to a property in order to support the closing

1 of a loan.

2 149. Further, according to allegations made by Capitol West Appraisals
3 LLC ("Capitol West") a real estate appraisal company cited in the Securities
4 Complaint, "Countrywide engaged in a pattern and practice of pressuring real
5 estate appraisers to artificially increase appraisal values for properties underlying
6 mortgages Countrywide originated and/or underwrote. Capitol West stated that
7 Countrywide loan officers sought to pressure Capitol West to increase appraisal
8 values for three separate loan transactions. When Capitol West refused to vary the
9 appraisal values from what it independently determined was appropriate,
10 Countrywide retaliated...."

11 150. According to Capitol West's allegations in the Securities Complaint,
12 "Countrywide maintained a database titled the 'Field Review List' containing the
13 names of appraisers whose reports Countrywide would not accept unless the
14 mortgage broker also submitted a report from a second appraiser. Capitol West
15 was placed on the Field Review List after refusing to buckle under pressure to
16 inflate real estate values. The practical effect of being placed on the Field Review
17 List was to be blacklisted as no mortgage broker would hire an appraiser appearing
18 on the Field Review List to appraise real estate for which Countrywide would be
19 the lender because neither the broker nor the borrower would pay to have two
20 appraisals done. Instead, the broker would simply retain another appraiser who
21 was not on the Field Review List." The Securities Complaint further sets forth
22 Capitol West's descriptions of the additional steps Countrywide took to enforce its
23 blacklisting of appraisers that refused to artificially inflate their appraisals.

24 151. On September 30, 2008, MBIA Insurance Corp. ("MBIA"), one of the
25 largest providers of bond insurance, filed a complaint against Countrywide in New
26 York state court, entitled *MBIA Ins. Corp. v. Countrywide*, No. 08/602825 (N.Y.
27 Sup. Ct.) (the "MBIA Complaint"). The MBIA Complaint alleges that
28 Countrywide fraudulently induced MBIA to provide insurance for certain

1 investment certificates, including those contained in the following trusts: CWHEQ
2 2005-E; CWHEQ 2005-I; CWHEQ 2005-M; CWHEQ 2006-E; CWHEQ 2006-G;
3 CWHEQ 2006-S8; CWHEQ 2007-E; CWHEQ 2007-S1; CWHEQ 2007-S2; and
4 CWHEQ 2007-S3.

5 152. MBIA was able to obtain approximately 19,000 loan files for the
6 Certificates it insured as a result of its contractual agreements with Countrywide.
7 After reviewing the portfolios and re-underwriting each loan provided by
8 Countrywide, MBIA discovered that there was “*an extraordinarily high incidence*
9 *of material deviations from the underwriting guidelines Countrywide represented*
10 *it would follow.*” MBIA Complaint, ¶ 78 (emphasis added). MBIA discovered
11 that many of the loan applications “lack[ed] key documentation, such as a
12 verification of borrower assets or income; include[d] an invalid or incomplete
13 appraisal; demonstrate[d] fraud by the borrower on the face of the application; or
14 reflect[ed] that any of borrower income, FICO score, or debt, or DTI [debt-to-
15 income] or CLTV, fail[ed] to meet stated Countrywide guidelines (without any
16 permissible exception).” MBIA Complaint, ¶ 79. Significantly, “MBIA’s re-
17 underwriting review ... revealed that almost 90% of defaulted or delinquent loans
18 in the Countrywide Securitizations show material discrepancies.” On April 27,
19 2010, the Supreme Court of the State of New York, although determining that
20 MBIA did not have a legal claim for negligent misrepresentation, denied a motion
21 to dismiss MBIA’s claims of fraud against several Countrywide entities and Bank
22 of America.

23 153. On April 11, 2008, an amended complaint for violations of the federal
24 securities laws was filed against Countrywide in the U.S. District Court for the
25 Central District of California. *See Argent Classic Convertible Arbitrage Fund LP*
26 *v. Countrywide Fin. Corp.*, No. 07-CV-7097-MRP-(MANx) (C.D. Cal.). The
27 complaint identified specific deviations from Countrywide’s stated underwriting
28 guidelines. For example, in connection with the “No Income/No Asset

Documentation Program,” Countrywide represented that “[t]his program is limited to borrowers with excellent credit histories.” However, Countrywide routinely extended these loans to borrowers with weak credit and knew that such “low doc” or “no doc” loans, particularly when coupled with nontraditional products like ARMs, likely contained misinformation from the borrower, such as overstated incomes, that increased the likelihood of defaults. Because borrowers were advised that their representations on loan applications would not be verified, Countrywide employees referred to these products as “liar loans.”

154. Furthermore, in an action commenced against Countrywide for wrongful termination, styled *Zachary v. Countrywide Fin. Corp.*, No. 4:08-cv-00214, currently pending in the U.S. District Court for the Southern District of Texas, the plaintiff, Mark Zachary (“Zachary”), a Regional Vice President of Countrywide KB Home Loans, Inc. (“CWKB”), alleged that CWKB, a 50-50 joint venture between Countrywide and KB Home Loans (“KB Home”), engaged in a host of mortgage origination and underwriting activities that did not comport with stated and standard practices. Zachary described how loan officers would go so far as to help the loan applicant submit a loan application with false income amounts, so that the applicant would get the loan under false pretenses.

155. According to Zachary, one of these practices involved CWKB’s practice of “flipping” a loan application from a “full documentation” loan program to a “stated income” or “no income, no asset” loan program. He learned that loans were being canceled at the prime regional operations center as full documentation loans and transferred to the subprime operations center in Plano, Texas, as stated asset, stated income (“SISA”) loans, a “low-doc” loan, or no income, no assets (“NINA”) loans, a “no-doc” loan. Otherwise known as “liar loans,” NINA loans allowed a borrower to simply state their income without providing any documentation or proof of this income. Thus, rather than denying an applicant based on the information revealed in the original mortgage application,

1 Countrywide pretended that it did not see the disqualifying information, such as
2 insufficient income or assets, and instead, allowed applicants to apply for a no
3 documentation loan, implicitly encouraging them to lie on these renewed
4 applications.

5 156. Furthermore, Zachary explained that while a material number of
6 Countrywide's loan applicants were not eligible for any loan program requiring
7 documentation based on the applicant's verified income level and/or job status,
8 CWKB loan officers would (1) cancel the application for the loan program that
9 required documentation, (2) re-do the application as a SISA or a NINA loan
10 through the company's subprime originators in Plano, Texas, and (3) coach the
11 loan applicant as to what income level he or she would need to have in order to
12 qualify for the low-doc or no-doc loan.

13 157. Moreover, according to Zachary, Countrywide blatantly ignored its
14 underwriting policies and procedures. Zachary stated that there was a problem
15 with appraisals performed on homes being purchased with Countrywide loans.
16 According to Zachary, the appraiser was being strongly encouraged to inflate
17 appraisal values by as much as 6% to allow the homeowner to "roll up" all closing
18 costs. According to Zachary, this inflated value put the buyer "upside down" on
19 the home immediately after purchasing it, *i.e.*, the borrower owed more than the
20 home's worth. Thus, the borrower was more susceptible to default. It also put the
21 lender and secondary market investor at risk because they were unaware of the true
22 value of their asset. According to Zachary, Countrywide performed an audit into
23 these matters in January 2007 which corroborates his story.

24 158. Another civil complaint, *Zaldana v. KB Home*, No. CV 08-3399
25 (EDL), currently pending in the U.S. District Court for the Northern District of
26 California (the "Zaldana Complaint"), further details Countrywide's failure to
27 follow standard appraisal practices. The Zaldana Complaint described a process
28 whereby KB Home paid Countrywide to make loans with subsidized initial

1 payments to KB borrowers, thereby allowing KB to prop up the ostensible sales
2 prices of KB homes and sell to buyers who would not otherwise be able to afford
3 or qualify for the monthly mortgage payments. In turn, Countrywide would have
4 its appraisers ignore the subsidies in order to appraise the home at the full stated
5 sales price, thereby inflating the actual value of the home (*i.e.*, the price that a
6 buyer was truly willing to pay for it).

7 **E. Underwriter Defendants “Contracted Out” and Failed to Conduct**
8 **Required Due Diligence of Loan Underwriting Guidelines**
9 **Contained in Offering Documents**

10 159. Prior to securitization, a process of cursory “due diligence” on the
11 mortgage loans was conducted. The review’s ostensible purpose was to determine
12 whether the loans contained the requisite legal documentation, were based on an
13 independent appraisal and were originated in accordance with Countrywide’s loan
14 underwriting guidelines, which were detailed in the Offering Documents. The due
15 diligence review that was conducted on the mortgage collateral was not specific to
16 any securitized pool of mortgage loans. Rather, the due diligence was periodically
17 performed on a small sample of Countrywide’s entire “warehouse” of mortgage
18 loans.

19 160. The Underwriter Defendants contracted out the inspection of loans for
20 compliance with the Originator’s underwriting guidelines to outside firms –
21 Clayton and The Bohan Group (“Bohan”) – and then conducted limited oversight
22 of these subcontractors’ activities.

23 161. As disclosed as part of an ongoing investigation of investment
24 banking misconduct in underwriting MBS being conducted by, among others, the
25 New York Attorney General (the “NYAG”) and the Massachusetts Attorney
26 General, Clayton and Bohan routinely provided investment banks with detailed
27 reports of loans non-compliant with underwriting guidelines, but the investment
28 banks just as routinely disregarded the non-compliant loans and included them in

1 securitization pools anyway. Further, the President of Bohan stated that, by the
2 time the Offerings of the Certificates took place, investment banks were requiring a
3 review of only 5% to 7% of the entire loan pools.

4 162. The Underwriter Defendants contracted their due diligence work to
5 Clayton and Bohan. The outside firms were supposed to examine the loans for
6 conformity with Countrywide's guidelines, as detailed in the Offering Documents.
7 Each loan reviewed was rated as category "1," "2" or "3." Category "3" loans
8 were defective and recommended for exclusion from securitization, however such
9 loans were routinely included in securitizations despite being defective. Because
10 the risk of default was passed on to investors in the Certificates rather than held by
11 the Underwriter Defendants or Countrywide, there was no incentive to remove
12 such category "3" loans from the Offerings, because if the Underwriter Defendants
13 rejected any significant portion of the loans, the size of the securitization, and thus
14 the size of the fees derived from the securitization, would decrease significantly.

15 163. In June 2007, the NYAG subpoenaed documents from Clayton and
16 Bohan related to their due diligence efforts on behalf of the investment banks, such
17 as Bear Stearns, that underwrote mortgage-backed securities. The NYAG, along
18 with Massachusetts and Connecticut attorneys general and the SEC (all of which
19 also subpoenaed documents), are investigating whether investment banks held
20 back information they should have provided in the disclosure documents related to
21 the sale of mortgage-backed securities to investors.

22 164. In a December 6, 2007 article published in *The New York Times*, it
23 was reported that:

24 Andrew Cuomo, the New York attorney-general, has
25 subpoenaed RBS and about 15 of Wall Street's biggest
26 sub-prime mortgage bond underwriters, such as Bear
27 Stearns and Merrill Lynch, requesting information that
28 will help to determine how much due diligence was
conducted on the home loan-backed securities that they
issued.

* * *

Mr. Cuomo is also examining the relationship between mortgage lenders, third party-due diligence firms, the credit rating agencies and the underwriting banks to see if they colluded to ignore risks.

Wall Street firms made hefty fees from buying high-risk sub-prime mortgages and packaging them into bonds backed by the home loans' interest payments. Investors, including Wall Street giants such as Citigroup, as well as hedge funds and pension funds, have collectively lost more than \$50 billion this year on sub-prime-backed bonds after a surge in defaults on high-risk home loans forced down their valuations.

Many of Wall Street's underwriters relied heavily on third-party vendors to examine the home loans that were used to back the mortgage bonds. This helped them to determine how reliable an income stream the underlying mortgages would produce and, in turn, how likely it was that the bonds' interest payments would be met.

Since bond underwriters have an obligation to make sure that the statements made in the securities' Offering Documents are accurate, Mr. Cuomo is investigating how much, if any, due diligence they conducted themselves. He is also seeking to determine whether they should have done more.

165. In a January 12, 2008 article titled "Inquiry Focuses on Withholding of Data on Loans," *The New York Times* further reported:

An investigation into the mortgage crisis by New York State prosecutors is now focusing on whether Wall Street banks withheld crucial information about the risks posed by investments linked to subprime loans.

Reports commissioned by the banks raised red flags about high-risk loans known as exceptions, which failed to meet even the lax credit standards of subprime mortgage companies and the Wall Street firms. But the

1 banks did not disclose the details of these reports to
2 credit-rating agencies or investors.

3 The inquiry, which was opened last summer by New
4 York's attorney general, Andrew M. Cuomo, centers on
5 how the banks bundled billions of dollars of exception
6 loans and other subprime debt into complex mortgage
investments, according to people with knowledge of the
matter. Charges could be filed in coming weeks.

7 * * *

8 The inquiries highlight Wall Street's leading role in
9 igniting the mortgage boom that has imploded with a
10 burst of defaults and foreclosures. The crisis is sending
11 shock waves through the financial world, and several big
12 banks are expected to disclose additional losses on
mortgage-related investments when they report earnings
next week.

13 As plunging home prices prompt talk of a recession, state
14 prosecutors have zeroed in on the way investment banks
15 handled exception loans. In recent years, lenders, with
16 Wall Street's blessing, routinely waived their own credit
guidelines, and the exceptions often became the rule.

17 It is unclear how much of the \$1 trillion subprime
18 mortgage market is composed of exception loans. Some
19 industry officials say such loans made up a quarter to a
20 half of the portfolios they saw. In some cases, the loans
21 accounted for as much as 80 percent. While exception
22 loans are more likely to default than ordinary subprime
23 loans, it is difficult to know how many of these loans
have soured because banks disclose little information
about them, officials say.

24 Wall Street banks bought many of the exception loans
25 from subprime lenders, mixed them with other mortgages
26 and pooled the resulting debt into securities for sale to
investors around the world.

27 * * *

1 Mr. Cuomo, who declined to comment through a
2 spokesman, subpoenaed several Wall Street banks last
3 summer, including Lehman Brothers and Deutsche Bank,
4 which are big underwriters of mortgage securities; the
5 three major credit-rating companies: Moody's Investors
6 Service, Standard & Poor's and Fitch Ratings; and a
7 number of mortgage consultants, known as due diligence
8 firms, which vetted the loans, among them Clayton
9 Holdings in Connecticut and the Bohan Group, based in
10 San Francisco. Mr. Blumenthal said his office issued up
11 to 30 subpoenas in its investigation, which began in late
12 August.

13 * * *

14 To vet mortgages, Wall Street underwriters hired outside
15 due diligence firms to scrutinize loan documents for
16 exceptions, errors and violations of lending laws. But
17 Jay H. Meadows, the chief executive of Rapid Reporting,
18 a firm based in Fort Worth that verifies borrowers'
19 incomes for mortgage companies, said ***lenders and
investment banks routinely ignored concerns raised by
these consultants.***

20 "Common sense was sacrificed on the altar of
21 materialism," Mr. Meadows said. "We stopped
22 checking."

23 (emphasis added).

24 166. On January 27, 2008, Clayton revealed that it had entered into an
25 agreement with the NYAG for immunity from civil and criminal prosecution in the
26 State of New York in exchange for agreeing to provide additional documents and
27 testimony regarding its due diligence reports, including copies of the actual reports
28 provided to its clients. Both *The New York Times* (J. Anderson and V. Bajaj,
"Reviewer of Subprime Loans Agrees to Aid Inquiry of Banks," *N.Y. Times*, (Jan.
27, 2008)) and *The Wall Street Journal* (A. Efrati and R. Simon, "Due Diligence
Firm to Aid New York Subprime Probe," *Wall St. J.* (Jan. 29, 2008)) ran articles
describing the nature of the NYAG's investigation and Clayton's testimony. *The*

1 *Wall Street Journal* reported that the NYAG's investigation was focused on "the
2 broad language written in prospectuses about the risky nature of these securities,"
3 which "changed little in recent years, even as due diligence reports noted that the
4 number of exception loans backing the securities was rising." According to the
5 *New York Times* article, Clayton told the NYAG "that starting in 2005, it saw a
6 significant deterioration of lending standards and a parallel jump in lending
7 expectations" and "some investment banks directed Clayton to halve the sample of
8 loans it evaluated in each portfolio."

9 167. A March 23, 2008 *Los Angeles Times* article reported that Clayton and
10 Bohan employees "raised plenty of red flags about flaws [in subprime home loans]
11 so serious that mortgages should have been rejected outright – such as borrowers'
12 incomes that seemed inflated or documents that looked fake – but the problems
13 were glossed over, ignored or stricken from reports" as follows:

14 The reviewers' role was just one of several safeguards –
15 including home appraisals, lending standards and ratings
16 on mortgage-backed bonds – that were built into the
country's mortgage-financing system.

17 But in the chain of brokers, lenders and investment banks
18 that transformed mortgages into securities sold
19 worldwide, no one seemed to care about loans that
20 looked bad from the start. Yet profit abounded until
21 defaults spawned hundreds of billions of dollars in losses
on mortgage-backed securities.

22 "The investors were paying us big money to filter this
23 business," said loan checker Cesar Valenz. "It's like
24 with water. If you don't filter it, it's dangerous. And it
didn't get filtered."

25 As foreclosures mount and home prices skid, the loan-
26 review function, known as "due diligence," is gaining
27 attention.

28 The FBI is conducting more than a dozen investigations
into whether companies along the financing chain

1 concealed problems with mortgages. And a presidential
2 working group has blamed the subprime debacle in part
3 on a lack of due diligence by investment banks, rating
outfits and mortgage-bond buyers.

4 E. Scott Reckard, "Subprime Watchdogs Ignored," *L.A. Times* (Mar. 23, 2008).

5 **F. Additional Government Investigations Further Confirm Systemic**
6 **Disregard for Mortgage Loan Underwriting Guidelines**

7 168. In August 2007, following reports of defaults in mortgage loans
8 underlying various MBS, downgrades of such MBS and potential downgrades of
9 additional MBS in the future, and the resulting illiquidity in the credit markets, the
10 President of the United States commissioned the Secretary of the Treasury, the
11 SEC and the Commodities Futures Trading Commission ("CFTC") (hereinafter
12 referred to as the "President's Working Group" or the "PWG") to investigate the
13 causes of the market turmoil. After a seven-month investigation, the PWG issued
14 its report on March 13, 2008. The PWG found as follows:

- 15
- 16 • A significant erosion of market discipline by those
17 involved in the securitization process, including
18 *originators, underwriters, credit rating agencies, and*
19 *global investors*, related in part to failures to provide or
20 obtain adequate risk disclosures;
 - 21 • The turmoil in financial markets clearly was triggered by
22 a *dramatic weakening of underwriting standards for*
23 *U.S. subprime mortgages...*

24 (emphasis added).

25 169. In December 2007, the Massachusetts Attorney General launched an
26 investigation into Wall Street's securitization of subprime loans. The investigation
27 focused on the industry practices involved in the issuance and securitization of
28 subprime loans to Massachusetts consumers. According to a press release issued
by the Massachusetts Attorney General's Office,

1 The Office is investigating whether securitizers may have:

- 2
- 3 • facilitated the origination of “unfair” loans under
 - 4 Massachusetts law;
 - 5 • failed to ascertain whether loans purchased from
 - 6 originators complied with the originators’ stated
 - 7 underwriting guidelines;
 - 8 • failed to take sufficient steps to avoid placing problem
 - 9 loans in securitization pools;
 - 10 • been aware of allegedly unfair or problem loans;
 - 11 • failed to make available to potential investors certain
 - 12 information concerning allegedly unfair or problem
 - 13 loans, including information obtained during loan
 - 14 diligence and the pre-securitization process, as well as
 - 15 information concerning their practices in making
 - 16 repurchase claims relating to loans both in and out of
 - 17 securitizations.

18

19 170. On January 30, 2008, the FBI and SEC launched a joint investigation

20 into 14 investment banks, loan providers and developers as part of a crackdown

21 focusing on the subprime mortgage crisis. According to the *Los Angeles Times*:

22 We’re looking at the whole range of those involved – including the

23 investment banks and other entities that bundled the loans up for sale

24 and the institutions that held them and reported [to investors] on their

25 value...

26

27 **G. Underwriter Defendants Employed Rating Shopping Practices to**

28 **Ensure Inflated Investment Grade Ratings for All the Certificates**

171. The Underwriter Defendants derived their profits from the sale of the

Certificates for a price in excess of the amount paid for the underlying mortgage

loans. For the Certificates to sell profitably, approximately 80% of the

securitization had to be assigned the highest AAA rating by the Rating Agencies.

172. As set forth above, the Underwriter Defendants ultimately engaged

the Rating Agencies through a “ratings shopping” process. Initially, a collateral

analyst would send the preliminarily structured deal to the Rating Agencies for

feedback. The Underwriter Defendants’ in-house rating agency personnel would

1 oversee the communications with the Rating Agencies. Then S&P, for example,
2 would run the loan tape through both its LEVELS and SPIRE Models again and
3 provide the Underwriter Defendants with the results in an effort to obtain the
4 ratings engagement. Through the LEVELS Model, S&P would advise the
5 Underwriter Defendants responsible for each deal, for example, that 94.25% of the
6 Certificates would be rated AAA as long as 5.75% of the total collateral balance
7 supporting those Certificates was subordinate. This 5.75% was the amount of loss
8 coverage required. The Underwriter Defendants would then again “negotiate” with
9 the Rating Agencies before they were hired, in order to get them to agree to the
10 least amount of loss coverage and credit enhancement, and the highest percentage
11 of AAA-designated Certificates.

12 173. The Underwriter Defendants used this “ratings shopping” process to
13 obtain the most profitable structure on the Offerings. Ratings shopping resulted in
14 *over 90%* of the Certificates being initially awarded the AAA/maximum-security
15 rating.

16 174. Finally however, in 2008, the practice was effectively ended by way
17 of an agreement entered into between the Rating Agencies and the NYAG. In June
18 2008, the NYAG announced that after an investigation of the Rating Agencies, it
19 had reached an agreement with S&P, Moody’s and Fitch which contemplated a
20 complete overhaul of the then-current ratings procedures and guidelines and put an
21 end to what had been termed “ratings shopping.” Instead of investment banks
22 looking to issue mortgage-backed bonds going to all three agencies for a review,
23 but only using, and paying for, the most optimistic rating, the Rating Agencies
24 would now be paid upfront regardless of whether they were hired to assign a
25 rating, a move expected to remove any potential for conflicts of interest.

VIII. THE OFFERING DOCUMENTS CONTAINED MATERIAL MISSTATEMENTS AND OMISSIONS REGARDING STATED UNDERWRITING AND APPRAISAL STANDARDS

175. Countrywide was a principal originator for all 14 of the Offerings complained of herein. The total value of the 14 Offerings for which Countrywide was the principal originator was \$17.83 billion, of which the Rating Agencies assigned initial ratings of AAA/maximum safety to over 90%.

176. Each Registration Statement at issue herein for the Issuing Trusts contained an illustrative form of a Prospectus Supplement for use in the offering of the Certificates. Each Registration Statement was prepared by the Issuer Defendants and signed by the Individual Defendants. At the effective date of the offering of the Certificates, a final Prospectus Supplement was filed with the SEC containing a description of the mortgage pool underlying the Certificates and the underwriting standards by which the mortgages were originated. The Underwriter Defendants sold the Certificates pursuant to the Prospectus Supplements.

177. Countrywide made clear in the Offering Documents that exceptions were made to the underwriting guidelines but only where “compensating factors were demonstrated by the borrowers. Each Registration Statement filed by CWALT and CWMBS at issue herein, as well as the Prospectus Supplements issued pursuant to those Registration Statements, contained the following language concerning the underwriting standards by which the mortgages pooled into CWALT and CWMBS Offerings were originated:

All of the Mortgage Loans have been originated or acquired by Countrywide Home Loans, Inc., in accordance with its credit, appraisal and underwriting standards.... Countrywide Home Loans’ underwriting standards are applied in accordance with applicable federal and state laws and regulations.

Countrywide Home Loans’ underwriting standards are applied, by or on behalf of Countrywide Home Loans to

1 evaluate the prospective borrower's credit standing and
2 repayment ability and the value and adequacy of the
3 mortgaged property as collateral. Under those standards,
4 a prospective borrower must generally demonstrate that
5 the ratio of the borrower's monthly housing expenses
6 (including principal and interest on the proposed
7 mortgage loan and, as applicable, the related monthly
8 portion of property taxes, hazard insurance and mortgage
9 insurance) to the borrower's monthly gross income and
10 the ratio of total monthly debt to the monthly gross
11 income (the "debt-to-income" ratios) are within
12 acceptable limits. The maximum acceptable debt-to-
13 income ratio, which is determined on a loan-by-loan
14 basis, varies depending on a number of underwriting
15 criteria, including the Loan-to-Value Ratio, loan purpose,
16 loan amount and credit history of the borrower. In
17 addition to meeting the debt-to-income ratio guidelines,
18 each prospective borrower is required to have sufficient
19 cash resources to pay the down payment and closing
20 costs. *Exceptions to Countrywide Home Loans'*
21 *underwriting guidelines may be made if compensating*
22 *factors are demonstrated by a prospective borrower.*

23 *See SAC Appendix Exhibit H; see also Exhibit I.*

24 178. The above statements concerning Countrywide's adherence to its
25 underwriting standards and to federal and state underwriting standards, with
26 respect to mortgages pooled into CWALT and CWMBS Issuing Trusts, contained
27 material misstatements when made because:

28 a. Defendants failed to disclose that Countrywide systematically
ignored underwriting standards imposed by state and federal law in issuing
the mortgages pooled into the Issuing Trusts;

b. Countrywide did not, contrary to its statement above, properly
"evaluate the prospective borrower's credit standing and repayment ability
and the value and adequacy of the mortgaged property as collateral."
Rather, as alleged herein, Countrywide systematically ignored borrowers'

1 repayment ability and the value and adequacy of mortgaged property used as
2 collateral in issuing loans; and

3 c. Countrywide's underwriting standards did not require that a
4 borrower "generally demonstrate that the ratio of the borrower's monthly
5 housing expenses (including principal and interest on the proposed mortgage
6 loan and, as applicable, the related monthly portion of property taxes, hazard
7 insurance and mortgage insurance) to the borrower's monthly gross income
8 and the ratio of total monthly debt to the monthly gross income (the 'debt-
9 to-income' ratios) are within acceptable limits." Instead, Countrywide's
10 underwriting included the following practices, described *supra* at ¶¶91-101,
11 151-75, that disregarded a borrowers' ability to pay by:

- 12
13 • Coaching borrowers to misstate their income on loan
14 applications to qualify for mortgage loans under
15 Countrywide's underwriting standards, including
16 directing applicants to no-documentation loan programs
17 when their income was insufficient to qualify for full
18 documentation loan programs;
- 19 • Steering borrowers to more expensive loans that
20 exceeded their borrowing capacity;
- 21 • Encouraging borrowers to borrow more than they could
22 afford by suggesting NINA and SISA loans when they
23 could not qualify for full documentation loans based on
24 their actual incomes;
- 25 • Approving borrowers based on "teaser rates" for loans
26 despite knowing that the borrower would not be able to
27 afford the "fully indexed-rate" when the adjustable rate
28 adjusted;
- Allowing non-qualifying borrowers to be approved for
loans under exceptions to Countrywide's underwriting
standards based on so-called "compensating factors"
without requiring documentation for such compensating
factors;

- Incentivizing its employees to approve borrowers under exceptions to Countrywide's underwriting policies; and
- Systematically overriding flags identified by the CLUES system that was meant to weed out non-qualifying loans and nonetheless approving such loans.

179. Each Registration Statement and Prospectus Supplement issued by CWABS and CWHEQ at issue herein contained the following language concerning the underwriting standards by which the mortgages pooled into the Issuing Trusts were originated:

Credit Blemished Mortgage Loans. The following is a description of the underwriting procedures customarily employed by Countrywide Home Loans with respect to credit blemished mortgage loans.... Countrywide Home Loans produces its credit blemished mortgage loans through its Consumer Markets, Full Spectrum Lending, Correspondent Lending and Wholesale Lending Divisions. Prior to the funding of any credit blemished mortgage loan, Countrywide Home Loans underwrites the related mortgage loan in accordance with the underwriting standards established by Countrywide Home Loans. In general, the mortgage loans are underwritten centrally by a specialized group of underwriters who are familiar with the unique characteristics of credit blemished mortgage loans. In general, Countrywide Home Loans does not purchase any credit blemished mortgage loan that it has not itself underwritten.

Countrywide Home Loans' underwriting standards are primarily intended to evaluate the value and adequacy of the mortgaged property as collateral for the proposed mortgage loan and the borrower's credit standing and repayment ability. On a case by case basis, Countrywide Home Loans may determine that, based upon compensating factors, a prospective borrower not strictly qualifying under the underwriting risk category guidelines described below warrants an underwriting exception. *Compensating factors may include low loan-*

1 *to-value ratio, low debt-to-income ratio, stable*
2 *employment, time in the same residence or other*
3 *factors. It is expected that a significant number of the*
4 *Mortgage Loans will have been originated based on*
5 *such underwriting exceptions.*

6 Each prospective borrower completes an application
7 which includes information with respect to the
8 applicant's assets, liabilities income and employment
9 history, as well as certain other personal information.
10 Countrywide Home Loans requires an independent credit
11 bureau report on the credit history of each applicant in
12 order to evaluate the applicant's prior willingness and/or
13 ability to repay. The report typically contains information
14 relating to credit history with local and national
15 merchants and lenders, installment debt payments and
16 any record of defaults, bankruptcy, repossession, suits or
17 judgments, among other matters. After obtaining all
18 applicable employment, credit and property information,
19 Countrywide Home Loans uses a debt-to-income ratio to
20 assist in determining whether the prospective borrower
21 has sufficient monthly income available to support the
22 payments of principal and interest on the mortgage loan
23 in addition to other monthly credit obligations. The
24 "debt-to-income ratio" is the ratio of the borrower's total
25 monthly credit obligations to the borrower's gross
26 monthly income. The maximum monthly debt-to-income
27 ratio varies depending upon a borrower's credit grade
28 and documentation level (as described below) but does
not generally exceed 50%. Variations in the monthly
debt-to-income ratios limit are permitted based on
compensating factors.

While more flexible, Countrywide Home Loans' underwriting guidelines still place primary reliance on a borrower's ability to repay; however, Countrywide Home Loans may require lower loan-to-value ratios than for loans underwritten to more traditional standards. Borrowers who qualify generally have payment histories and debt-to-income ratios which would not satisfy more traditional underwriting guidelines and may have a record of major derogatory credit items such as outstanding judgments or prior bankruptcies.

Countrywide Home Loans' credit blemished mortgage loan underwriting guidelines establish the maximum permitted loan-to-value ratio for each loan type based upon these and other risk factors with more risk factors resulting in lower loan-to-value ratios.

See SAC Appendix Exhibit J; see also Exhibit K.

180. In addition, the Prospectus Supplements issued pursuant to the CWHEQ Registration Statements at issue herein also contained additional language describing the standards by which CWHEQ's home equity loans and second lien mortgage loans were originated:

The underwriting process is intended to assess the applicant's credit standing and repayment ability, and the value and adequacy of the real property security as collateral for the proposed loan. Exceptions to the applicable originator's underwriting guidelines will be made when compensating actors are present. These factors include the borrower's employment stability, favorable credit history, equity in the related property, and the nature of the underlying first mortgage loan.

See SAC Appendix Exhibit L.

181. The Prospectus Supplements for the Offerings issued pursuant to the CWHEQ Registration Statements at issue herein also stated:

After obtaining all applicable income, liability, asset, employment, credit, and property information, the applicable originator generally uses a debt-to-income ratio to assist in determining whether the prospective borrower has sufficient monthly income available to support the payments on the home equity loan in addition to any senior mortgage loan payments (including any escrows for property taxes and hazard insurance premiums) and other monthly credit obligations. The "debt-to-income ratio" is the ratio of the borrower's total monthly credit obligations (assuming the mortgage loan interest rate is based on the applicable fully indexed

1 interest rate) to the borrower's gross monthly income.
2 Based on this, the maximum monthly debt-to-income
3 ratio is 45%. Variations in the monthly debt-to-income
4 ratios limits are permitted based on compensating factors.
5 The originators currently offer home equity loan products
6 that allow maximum combined loan-to-value ratios up to
7 100%.

8 **See SAC Appendix Exhibit M.**

9 182. The above statements contained material misstatements of fact when
10 made because:

11 a. Contrary to the statements that Countrywide's underwriting
12 standards were "primarily intended to evaluate the value and adequacy of
13 the mortgaged property as collateral for the proposed mortgage loan" and to
14 evaluate "the borrower's credit standing and repayment ability,"
15 Countrywide subordinated its underwriting standards to originating and
16 securitizing as many mortgage loans as it could so that it could garner fees
17 in the secondary mortgage market. As alleged herein, Countrywide
18 systematically ignored borrowers' repayment ability and the value and
19 adequacy of mortgaged property used as collateral in issuing loans. Rather,
20 Countrywide designed its underwriting standards to ensure that it received
21 the highest possible fees for originating loans without regard to the actual
22 ability of its borrowers to repay the loan, or whether the mortgaged property
23 had sufficient value to collateralize the loan.

24 b. Contrary to the representation above that "After obtaining all
25 applicable employment, credit and property information, Countrywide
26 Home Loans uses a debt-to-income ratio to assist in determining whether the
27 prospective borrower has sufficient monthly income available to support the
28 payments of principal and interest on the mortgage loan in addition to other
monthly credit obligations," Countrywide's underwriting included the

1 following practices, described *supra* at ¶¶91-101, 151-75, that disregarded a
2 borrowers' ability to pay by:

- 3 • Coaching borrowers to misstate their income on loan
4 applications to qualify for mortgage loans under
5 Countrywide's underwriting standards, including
6 directing applicants to no-documentation loan programs
7 when their income was insufficient to qualify for full
8 documentation loan programs;
- 9 • Steering borrowers to more expensive loans that
10 exceeded their borrowing capacity;
- 11 • Encouraging borrowers to borrow more than they could
12 afford by suggesting NINA and SISA loans when they
13 could not qualify for full documentation loans based on
14 their actual incomes;
- 15 • Approving borrowers based on "teaser rates" for loans
16 despite knowing that the borrower would not be able to
17 afford the "fully indexed rate" when the adjustable rate
18 adjusted;
- 19 • Allowing non-qualifying borrowers to be approved for
20 loans under exceptions to Countrywide's underwriting
21 standards based on so-called "compensating factors"
22 without requiring documentation for such compensating
23 factors;
- 24 • Incentivizing its employees to approve borrowers under
25 exceptions to Countrywide's underwriting policies; and
- 26 • Systematically overriding flags identified by the CLUES
27 system that were meant to weed out non-qualifying loans
28 and, despite the flags, approving such loans.

c. Contrary to the statement that "Exceptions to the applicable
originator's underwriting guidelines will be made when compensating
factors are present" and that those factors included "the borrower's
employment stability, favorable credit history, equity in the related property,

1 and the nature of the underlying first mortgage loan,” Countrywide adopted
2 procedures to incentivize its employees to approve exceptions to loans
3 regardless of whether any compensating factors were present.

4 183. Each Registration Statement issued by CWALT, CWABS, CWMBS
5 and CWHEQ at issue herein contained the following statement regarding
6 Countrywide’s assessment of a prospective borrower:

7
8 Once all applicable employment, credit and property
9 information is received, a determination generally is
10 made as to whether the prospective borrower has
11 sufficient monthly income available to meet monthly
12 housing expenses and other financial obligations and
13 monthly living expenses and to meet the borrower’s
14 monthly obligations on the proposed mortgage loan
15 (generally determined on the basis of the monthly
16 payments due in the year of origination) and other
17 expenses related to the mortgaged property such as
18 property taxes and hazard insurance). *The underwriting
standards applied by sellers, particularly with respect to
the level of loan documentation and the mortgagor’s
income and credit history, may be varied in appropriate
cases where factors as low Loan-to-Value Ratios or
other favorable credit factors exist.*

19 See SAC Appendix Exhibit N.

20 184. Each Registration Statement issued by CWALT, CWABS, CWMBS
21 and CWHEQ at issue herein contained the following statement regarding
22 Countrywide’s review of information provided by a prospective borrower:

23
24 Under the Stated Income/Stated Asset Documentation
25 Program, the mortgage loan application is *reviewed to
26 determine that the stated income is reasonable for the
27 borrower’s employment and that the stated assets are
consistent with the borrower’s income.*

28 See SAC Appendix Exhibit O.

1 185. According to the Registration Statement and Prospectus Supplements
2 issued by CWALT at issue herein, Countrywide originated loans pursuant to a
3 Preferred Processing Program, pursuant to which documentation requirements
4 were waived for those applicants with favorable credit histories and higher FICO
5 scores.

6
7 Under Countrywide Home Loans' underwriting
8 guidelines, borrowers possessing higher FICO Credit
9 Scores, *which indicate a more favorable credit history*,
10 and who give Countrywide Home Loans the right to
11 obtain the tax returns they filed for the preceding two
12 years may be eligible for Countrywide Home Loans'
13 processing program (the "Preferred Processing
14 Program").Countrywide Home Loans may waive
15 some documentation requirements for mortgage loans
16 originated under the Preferred Processing Program.

17 *See SAC Appendix Exhibit P; see also Exhibit Q.*

18 186. Furthermore, under the CWALT Registration Statement at issue
19 herein, Countrywide also offered four programs where less than full borrower
20 documentation of income, assets and employment were required, however, in all
21 instances credit scores had to be obtained and any deficiencies or derogations fully
22 explained to the loan officers and, except for the Streamlined Documentation
23 Program which had limited application, independent appraisals of the mortgage
24 properties obtained – with all appraisals conforming to Fannie Mae and Freddie
25 Mac standards:

26 A prospective borrower may be eligible for a loan
27 approval process that limits or eliminates Countrywide
28 Home Loans' standard disclosure or verification
requirements or both. Countrywide Home Loans offers
the following documentation programs as alternatives to
its Full Documentation Program: an Alternative
Documentation Loan Program (the "Alternative
Documentation Program"), a Reduced Documentation

1 Loan Program (the "Reduced Documentation Program"),
2 a CLUES Plus Documentation Loan Program (the
3 "CLUES Plus Documentation Program"), a No
4 Income/No Asset Documentation Loan Program (the "No
5 Income/No Asset Documentation Program"), a Stated
6 Income/Stated Asset Documentation Loan Program (the
7 "Stated Income/Stated Asset Documentation Program")
8 and a Streamlined Documentation Loan Program (the
9 "Streamlined Documentation Program").

10 *For all mortgage loans originated or acquired by*
11 *Countrywide Home Loans, Countrywide Home Loan*
12 *obtains a credit report relating to the applicant from a*
13 *credit reporting company. The credit report typically*
14 *contains information relating to such matters as credit*
15 *history with local and national merchants and lenders,*
16 *installment debt payments and any record of defaults,*
17 *bankruptcy, dispossession, suits or judgments. All*
18 *adverse information in the credit report is required to be*
19 *explained by the prospective borrower to the satisfaction*
20 *of the lending officer.*

21 *Except with respect to mortgage loans originated*
22 *pursuant to its Streamlined Documentation Program,*
23 *Countrywide Home Loans obtains appraisals from*
24 *independent appraisers or appraisal services for*
25 *properties that are to secure mortgage loans. The*
26 *appraisers inspect and appraise the proposed mortgaged*
27 *property and verify that the property is in acceptable*
28 *condition. Following each appraisal, the appraiser*
prepares a report which includes a market data analysis
based on recent sales of comparable homes in the area
and, when deemed appropriate, a replacement cost
analysis based on the current cost of constructing a
similar home. All appraisals are required to conform to
Fannie Mae or Freddie Mac appraisal standards then
in effect.

See SAC Appendix Exhibit R; see also Exhibit S.

187. In addition, the Offering Documents for the CWALT Offerings at issue herein stated that the Alternative Documentation Program required, in addition to FICO scores and standard appraisals, W-2 forms instead of tax returns

1 for two years and bank statements instead of deposits and employment verification:

2
3 The Alternative Documentation Program permits a
4 borrower to provide W-2 forms instead of tax returns
5 covering the most recent two years, permits bank
6 statements in lieu of verification of deposits and permits
7 alternative methods of employment verification.

8 *See SAC Appendix Exhibit T; see also Exhibit U.*

9 188. The Reduced Documentation Program, according to the CWALT
10 Offering Documents at issue herein, was only applied where maximum LTV was
11 equal to or less than 75% including secondary financing as follows:

12 Under the Reduced Documentation Program, some
13 underwriting documentation concerning income,
14 employment and asset verification is waived.
15 Countrywide Home Loans obtains from a prospective
16 borrower either a verification of deposit or bank
17 statements for the two-month period immediately before
18 the date of the mortgage loan application or verbal
19 verification of employment. Since information relating to
20 a prospective borrower's income and employment is not
21 verified, the borrower's debt-to-income ratios are
22 calculated based on the information provided by the
23 borrower in the mortgage loan application. The
24 maximum Loan-to-Value Ratio, including secondary
25 financing, ranges up to 75%.

26 *See SAC Appendix Exhibit V; see also Exhibit W.*

27 189. Furthermore, the CLUES Plus program also had a 75% LTV limit but
28 required borrower bank statements and excluded cash out refinancing:

29 The CLUES Plus Documentation Program permits the
30 verification of employment by alternative means, if
31 necessary, including verbal verification of employment
32 or reviewing paycheck stubs covering the pay period
33 immediately prior to the date of the mortgage loan
34 application. To verify the borrower's assets and the
35 sufficiency of the borrower's funds for closing,